



State of New Jersey
DEPARTMENT OF THE TREASURY
DIVISION OF PENSIONS AND BENEFITS
(609) 292-7524 TDD (609) 292-7718
www.state.nj.us/treasury/pensions

JON S. CORZINE
Governor

MAILING ADDRESS:
PO Box 295
TRENTON, NJ 08625-0295

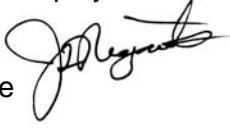
LOCATION:
50 WEST STATE STREET
TRENTON, NEW JERSEY

R. DAVID ROUSSEAU
State Treasurer

FREDERICK J. BEAVER
Director

May 6, 2008

TO: Certifying Officers Local Employers

FROM: John D. Megariotis 
Deputy Director, Finance

SUBJECT: **Independent Contractors and Professional Services Contracts under Chapter 92, P.L. 2007**

Chapter 92, P.L. 2007, addressed several areas of pension and health benefit law¹, including prohibitions on enrollment and/or continued participation for certain individuals in any public retirement system. This letter outlines the criteria and procedures for employers when addressing continued eligibility and enrollment of employees for membership in the Public Employees' Retirement System (PERS) or the Teacher Pension and Annuity Fund (TPAF), specifically: (a) individuals performing service pursuant to a **professional services contract** and (b) **independent contractors**.

The provisions of Chapter 92 present significant and ongoing responsibilities for local officials when hiring employees and enrolling eligible pension members. Careful attention must be given to the provisions of Chapter 92 to ensure the local public employer is in compliance with the law. For employers operating under the supervision of the Division of Local Government Services, this letter supplements information provided in Local Finance Notices 2007-28 and 2008-10.

PROFESSIONAL SERVICE CONTRACTS

A professional service is one that meets the definition in the Local Public Contracts Law at N.J.S.A. 40A:11-2 and is entered into without public bidding (i.e., exempt from public bidding).

The term "professional" or "professional services" further refers to the definition of professional services as follows:

"Professional services" means services rendered or performed by a person authorized by law to practice a recognized profession, whose practice is regulated by law, and the performance of which services requires knowledge of an advanced type in a field of learning acquired by a prolonged formal course of specialized instruction and study as distinguished from general academic instruction or apprenticeship and training.

¹ Chapter 92, P.L. 2007, also established a new retirement program, the Defined Contribution Retirement Program (DCRP), for certain elected and appointed public officials. DCRP eligibility and enrollment is addressed in a separate Certifying Officer Letter of March 20, 2008.

Professional services may also mean services rendered in the provision or performance of goods or services that are original and creative in character in a recognized field of artistic endeavor.”

Typically these positions include attorneys, engineers, architects, planners, public health professionals; but exclude for example, construction and fire code officials. (These professions are used for example and are not an exhaustive list of positions.)

Effective January 1, 2008, Chapter 92 provides that if a person is employed under a professional services contract, membership in the PERS, TPAF or the DCRP is *prohibited* with regards to that service. Individuals enrolled in the PERS or TPAF who are performing professional services pursuant to a contract entered into *prior to* January 1, 2008, will continue to accrue pension credit for the remainder of that contract year. However, the individual will not be eligible for any further retirement system credit for the performance of those services after that contract period expires.

This prohibition applies to any extension, modification, or other agreement to continue a professional services contract beyond its current term. It is also important to consider that State contracting laws do not permit professional service contracts to be for more than one year and they cannot be extended. Therefore, for local governing bodies operating on a calendar year basis, no individual holding a professional services contract with these locations should have contributed to the retirement system after December 31, 2007. Similarly, entities operating on a fiscal basis may have contracts which extend to the end of the fiscal year; the latest allowable date for reporting of retirement system service would be June 30, 2008.

Further, there are specific exceptions related to DCRP membership pursuant to N.J.S.A. 43:15C-2(a) and (b), whereas an individual who holds a state issued license or certificate to perform and is serving in any of the following capacities, the person is qualified to join or remain in PERS: certified health officer; tax collector; chief financial officer; construction code official; qualified purchasing agent; tax assessor; municipal planner; registered municipal clerk; licensed uniform sub-code inspector; and certified public works manager.

As can be seen, pension eligibility — or ineligibility — under Chapter 92 may be highly fact sensitive. For example, a full-time in-house counsel may be providing professional services to a public entity pursuant to a professional services contract and the individual's eligibility for PERS service credit is guided by the professional services analysis herein. A full-time in-house counsel, however, may be eligible to continue in the PERS if the counsel was a member of the PERS prior to July 1, 2007, the employment is not tied to a professional services contract, and the individual does not meet the independent contractor test as set forth later in this letter.

Employers with specific questions regarding professional services contracts or independent contractors should address them in writing — by letter or e-mail — to the Division of Pensions and Benefits. If sending an e-mail, list “professional services” as the subject line. If an employer has reported service or salary to the retirement system in error with regards to an individual covered by a professional services contract which commenced on or after January 1, 2008, the employer must contact the Division of Pensions and Benefits - Audit Section to initiate the correction.

INDEPENDENT CONTRACTORS

In addition to prohibiting retirement system membership for certain professionals that perform services under a professional service contract, Chapter 92 also requires elimination of independent contractors from membership in either the PERS or TPAF. Further, these individuals are not eligible for membership in the DCRP. This should be considered when local employers make decisions on hiring and contracting.

The law also brings into play Internal Revenue Service (IRS) rules on determining if an individual is an employee or independent contractor. The Certifying Officer of each local employer must review their current and future professional employees and use the IRS criteria (below) to determine if the individual meets the requirements of an employee and thus membership in the PERS, TPAF, or DCRP. If the individual fails the employee test, the individual is considered to be a contractor. This requires termination of pension reporting for the individual from that employer location, termination of related benefits, and affects federal employment taxing requirements.

While Chapter 92 specifies the elimination of independent contractors who perform professional services from retirement system membership, please note that independent contractors have historically been ineligible for retirement system membership, as an employee/employer relationship has always been one of the conditions of retirement system membership.

IRS TEST FOR INDEPENDENT CONTRACTOR

The Division uses the IRS test to determine whether an individual is an independent contractor. All of the factors listed below must be evaluated to render a determination². They are:

- A) **Behavioral Control** – Included in this test are instructions and training.
- (1) Instructions – if the individual receives extensive instructions on how work is to be done, this suggests an employee relationship exists. Ask how, when, or where the person is asked to do the work; what and who owns the tools or equipment used; what assistants are hired to help with the work and where and by whom supplies and services are purchased. If one receives less extensive instructions about what should be done, but not how it should be done, the person *may be* an independent contractor. Each of these factors will vary dependent upon the actual position.
 - (2) Training – If the business provides training about required procedures and methods, this indicates that the business wants the work done in a certain way, and that suggests that the individual may be an employee.

² The IRS test factors listed in this letter replace the 20 factor test set previously used by the IRS to determine independent contractor or employee status. The 20 factors included: degree of control; right to discharge; right to delegate work; right to hire and fire assistants; payment by the hour; furnishing of training; skill; duration of relationship; control over hours of work; independent trade; furnishing tools; place of work; profit and loss; intent of the parties; principal in business; sequence of work; reports required; same work as others classified as employees; integration; and industry custom.

B) **Financial Control** – Included in this test are facts which would reveal whether there is a right to direct or control the business part of the work. Examples are:

- (1) If the individual has made a significant investment in a position, this may qualify as an independent contractor.
- (2) If the individual is not reimbursed for some or all business expenses, then he or she may qualify as an independent contractor, especially if unreimbursed business expenses are high.
- (3) If the individual can realize a profit or incur a loss, this suggests that the person is in business for themselves and may be an independent contractor.

C) **Relationship to Parties** – These are facts that illustrate how the business and the worker perceive their relationship. For example:

- (1) Does the person receive benefits such as paid leave or insurance? This may indicate employee status.
- (2) Written contracts – A written contract may show what both the individual and the employer intend.

No one of these factors is controlling and the response to all factors must be weighed together, under the common law definition of "employment." However, one of the most important factors for consideration is whether the employer has the right to instruct and control the employee with respect to the details of the work that is performed by the employee.

Since the Division of Pensions and Benefits uses the established IRS Employee Test (commonly known as Revenue Ruling 87-41) as the basis for determining employee or independent contractor status, local employers have a standard assessment tool and the opportunity for formal guidance. There are several IRS documents that discuss how to evaluate the individual circumstance. These are:

- *IRS Publication 1779*, a two-page brochure that summarizes the IRS Employee Test. It is available from the IRS at: www.irs.gov/pub/irs-pdf/p1779.pdf
- *IRS Publication 15a*, about employees and the employer-employee relationship which includes examples of employees and contractors. It also discusses employee tax liability issues. It is available from the IRS at: www.irs.gov/pub/irs-pdf/p15a.pdf
- *IRS Publication 963*, the "Federal-State Reference Guide", a comprehensive reference source for Social Security and Medicare coverage and Federal Insurance Contributions Act (FICA) tax withholding issues. Chapter 4 of this document provides details on determining worker status. It is available from the IRS at: www.irs.gov/pub/irs-pdf/p963.pdf

As part of its services to employers, the IRS will also look at individual circumstances and provide a determination for the purposes of federal employment taxes and income tax withholding. Because these two issues are at the heart of the IRS assessment, local employers can contact the IRS to obtain a definitive answer if local analysis is inconclusive. *IRS Form SS-8* can be used to request a determination. The form is available online at: www.irs.gov/pub/irs-pdf/fss8.pdf.

In summary:

- By applying the IRS Employee Test, the local employer's Certifying Officer must document that all professionals are not independent contractors. If they fail the test (and are considered a contractor), appropriate actions should be taken (i.e., canceling pension system membership).
- Special circumstances will require careful legal analysis to ensure compliance.

Because of the importance of the criteria used to apply the independent contractor test, it is suggested that the Certifying Officer analyze the facts, document the analysis, and keep it with the employee's personnel file. This may become important if the local employer is audited by the Division of Pensions and Benefits, and is an important internal control that is subject to testing by the local unit's auditor.

Individuals whose pension system membership is ending as a result of the above provisions (prohibition of further retirement system credit for individuals holding professional services contracts or retained as independent contractors), may take one of the following actions:

1. Retire, if eligible;
2. Withdraw their pension contributions; or
3. Obtain other PERS or TPAF eligible employment within two years of the last eligible retirement system contribution to continue to accrue service in PERS or TPAF.

Members who will no longer be eligible for continuing their membership in the pension system may view additional pension information at the Division's Web site: www.state.nj.us/treasury/pensions.